CalPERS

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AGENDA ITEM 4-D

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Senate Bill 1187 (Ackerman) – As Introduced

Judges' Retirement System II (JRS II)

Co-Sponsors: Judicial Council of California; California Judges Association

II. PROGRAM: Legislation

III. RECOMMENDATION: Neutral, with suggested amendments

This bill would allow a judge who has accrued five or more years of service, but who is not yet eligible for normal retirement, to receive an actuarially equivalent annuity in exchange for the judge's accrued monetary credits.

IV. ANALYSIS:

This bill would authorize the California Public Employees' Retirement System (CalPERS) to offer the option of an actuarially equivalent lifetime annuity to a vested judge under the Judges' Retirement System II (JRS II) who leaves judicial office before becoming eligible for normal retirement and wishes to convert the lump-sum payout to an actuarially equivalent annuity.

Background

The JRS II was established in 1994 to create a pre-funded, actuarially-sound retirement system for Supreme and Appellate Court justices, Superior Court judges, and Municipal Court judges appointed or elected on or after November 9, 1994. (Since all counties have consolidated their Municipal Courts with their Superior Courts under Proposition 220, there are no longer active Municipal Court judges.)

The employer contribution rate from the inception of the plan until June 30, 1996 was set by statute. Subsequently, the employer contribution rate is determined through an actuarial valuation process. The judges, as members of the system, contribute 8 percent of their annual compensation to the plan.

The JRS II offers a combination of two basic types of retirement benefits: a defined benefit and a monetary credit. The defined benefit provides a lifetime monthly benefit equal to 3.75 percent per year of service up to 75 percent of final compensation. The monetary credit provides a single lump sum payment at retirement based on the judge's monetary credit balance. A judge accrues monetary credits equal to 18 percent of the judge's monthly salary plus the annual net earnings rate which cannot be less than zero.

A judge is eligible for "normal retirement" upon attaining both age 65 with 20 or more years of service, or attaining 70 years of age with at least 5 years of service. Under normal retirement, a judge may choose to receive either a defined benefit or a monetary credit amount. If the judge elects to receive the monetary credit amount under normal retirement, current law allows the judge to further choose either a lump-sum payout or "an annuity of actuarially equivalent value" for life as well as the right to elect an optional settlement providing a lifetime benefit after his/her death to a surviving spouse.

By comparison, a judge who leaves judicial service before accruing five years of service is only entitled to receive the amount of his or her contributions (8 percent of annual compensation) to the system and no other amount. If a judge leaves judicial office after accruing at least five years of service and is not yet eligible for normal retirement, the judge would only receive the balance of his/her monetary credits in a lump sum payout. Once the judge withdraws his or her accumulated contributions or monetary credits, the service shall not count in the event he or she later becomes a judge again, until the withdrawn amount plus interest is paid back to the JRS II Fund.

Additional information regarding the composition of the JRS II Fund is provided below

Active Members (as of July 31, 2005)	762
Retirees, Survivors and Beneficiaries (as of December 31, 2005)	7
Benefit Payments Fiscal Year to date (as of December 31, 2005)	$388,828
Benefit Payments Fiscal Year 2004-05	$831,677

Proposed Changes

This bill would permit a judge with at least five years of service who is not eligible for normal retirement the option to receive his or her monetary credits in an annuity of actuarially equivalent value for life rather than a single payment. The judge would also have the right to elect an optional settlement and provide a lifetime benefit after his or her death to a surviving spouse. This option is the same as that available to the judge who elects the monetary credits under normal retirement.

Legislative History

1994 Chapter 879 (SB 65, McCorquodale) required all new judges appointed or elected to be covered under a new retirement plan (JRS II). The bill provided that the new retirement plan be funded through contributions from the judges, the state, the investment earnings of the JRS II Fund, and a portion of civil filing fees. *CalPERS' position: Support*

Issues

1. Arguments by Those in Support

   The Judicial Council of California argues that under current law, a significant portion of the value of a Judges' Retirement System II (JRS II) member's monetary credits can be lost when the judge retires early and seeks to convert the lump-sum payout to a lifetime annuity in the open market. The sponsor states that authorizing CalPERS to offer an annuity in exchange for the monetary credits accumulated by a judge who leaves judicial office before becoming eligible for normal retirement would not expand retirement benefits. It would simply protect the value of the judge's already-accrued benefit.

   Organizations in Support: Judicial Council of California (Sponsor); California Judges Association (Co-sponsor)

2. Arguments by Those in Opposition

   There is no known opposition at this time.

3. Option to Convert the Monetary Credit to an Actuarially Equivalent Annuity

   Currently, CalPERS does not have statutory authority to convert the monetary credits to an "actuarially equivalent annuity" for a vested judge who has five years of service and leaves office before becoming eligible for normal retirement. To convert the lump-sum monetary credits to an annuity, a vested judge must do so in the open market with a state-regulated life insurance company. State law imposes numerous restrictions on annuity issuers, including a requirement that they invest the largest portion of the annuity assets in low-yield bonds and similar fixed-income investments rather than higher yield, albeit riskier, equity investments.

As a state-governmental agency, CalPERS is not subject to the same statutory restrictions that are imposed on private insurers, and is able to invest the larger portion of its portfolios in equities. In addition CalPERS may be able to provide an annuity with lower administration costs (e.g., no sales commission, no state premium tax, and no allowance for profit). The combination of these factors may make it more attractive for CalPERS to offer an "actuarially equivalent" annuity than it would be to purchase one in the open market. The CalPERS Board may need to adjust annuity factor options to reflect actual experience.

4. Medical Coverage for Early Retirees

The eligibility or administration of medical coverage under PEMCHA would not change as a result of this legislation. A vested judge who retires "early" and leaves judicial office before attaining age 65 would still need to assume the premium payments and an additional two percent of the premium amount to cover administrative expenses to continue his or her medical coverage and the coverage of any family members. Once the judge attains age 65, and has maintained continuous coverage from the day her or she left office, he or she would then be entitled to employer contributions. On the other hand, a judge who cancels medical coverage may not reenroll.

5. Legislative Policy Standards

The Board's Legislative Policy Standards suggest a neutral position on proposals which do not significantly affect the benefit interests of our stakeholders' and which do not significantly impact CalPERS' benefits or the administration of the System. SB 1187 would allow a vested judge who is not yet eligible for normal retirement the option of receiving an actuarially equivalent annuity in exchange for the accrued monetary credits.

This bill should be amended to clarify that monetary credits paid out in an actuarially equivalent annuity must be paid back into the JRS II Fund before a judge can return to the bench.

V. STRATEGIC PLAN:

This item is not a product of the CalPERS strategic plan, but an ongoing responsibility of the CalPERS Office of Governmental Affairs.

VI. RESULTS/COSTS:

If enacted, this bill would provide a new payment option for vested judges who retire early. This would result in a slight increase in administrative costs and unknown program costs.

<u>Program Costs</u>

Program costs are unknown at this time. The conversion of the monetary credits lump sum to an annuity will be performed on an actuarially equivalent basis. While this is expected to be cost neutral to the employer, actuarial equivalent calculations require a large pool of individuals for costs to remain neutral and it is anticipated that the pool of members electing to annuitize may be too small for this purpose.

Additionally, members could select against the system – those in bad health at the time of retirement might elect to receive a lump sum payout while those in good health might elect to annuitize. Experience over time will determine the actual versus expected gains and losses of those electing to annuitize. Should gains or losses occur, the employer, in this case the State of California will benefit from any actuarial gains and conversely, will be responsible for covering the costs of losses.

<u>Administrative Costs</u>

Currently, a judge who leaves judicial office after accruing at least five years of service and is not yet eligible for normal retirement would only receive the balance of his/her monetary credit plan in a lump sum payout, resulting in a one-time fixed administrative cost.

By permitting a judge who is not yet eligible to retire under a normal retirement, to elect to receive an actuarially equivalent annuity in exchange for the judge's accrued monetary credit, administrative costs will be ongoing for monthly account maintenance activities, including those activities/costs associated with the account of a surviving spouse. It is anticipated that ongoing administrative costs will be minimal.

Additionally, one-time and recurring charges for resource allocation and actuarial work to set up the administrative worksheets, training on the use of these worksheets, and on-going benefit calculations are shown below.

TYPE OF WORK	CHARGE*	FREQUENCY
Spreadsheet creation, review, and training on use	$ 11,500	One-time
Benefit calculation review	$ 190	Per benefit calculation review

- Actuarial Office Work Estimates

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